Sustainable finance and ESG in Hong Kong

Background – global drivers of sustainable finance and ESG

In recent years, there has been increasing attention globally on environmental, social and governance (ESG) issues, with accelerated focus following the 2020 outbreak of the pandemic on concerns of sustainability and broader social issues such as healthcare, rising poverty and social inequalities. COP26 this year will be the fifth anniversary of the entry into force of the Paris Agreement, as a legally binding international agreement under the United Nations Framework Convention on Climate Change. Many countries and governments are committing to meeting Paris-aligned climate targets, towards limiting global warming to well below 2°C and pursuing efforts to limit it to 1.5°C. There is increasing urgency that much more concrete steps and significant levels of investments are needed through green or sustainable finance, or the world would likely miss this target, with potential catastrophic consequences of climate change that would need to be addressed.

Alongside, there is growing recognition of the need for policymakers, financial regulators and financial markets, including asset owners, financial institutions, investment managers, institutional investors as well as corporations and businesses, to take into account climate or environmental risks, as well as potential systemic risks, portfolio risks, physical, business and financial risks.

On the other hand, investors and the public are expecting corporations to manage the ESG risks in their businesses and also factor in the environmental, social and community impact of their activities. Failure to do so may involve reputational risks, financial impact, potential lawsuits or other legal risks, and in some cases even threatening a company's social licence to operate. Companies now need to review and evolve their corporate social responsibility (CSR) beyond philanthropic efforts that tended to be separate from their business operations, towards adopting strategies and policies that integrate sound ESG considerations and practices across their business activities and supply chains.

Perhaps in response to such calls, there are also movements on the values of business as a force for good, such as the idea of the "Purpose of a Corporation" which has been put forward by the Business Roundtable consisting of prominent US or global CEOs, and significantly the emergence of benefit corporations and certified B Corps in many parts of the world as new corporate forms that legally commit to meeting not just shareholder interests, but also the interests of other stakeholders, and to pursue material positive impact on society and the environment.

In this context, the 17 Sustainable Development Goals (SDGs) of the 2030 Agenda for Sustainable Development adopted by all United Nations member states in 2015 are now often referred to as the framework for considering environmental and social goals and outcomes, including around climate action, clean energy and biodiversity, eliminating hunger and poverty, improving education and healthcare, reducing inequalities, and building sustainable cities and infrastructure.

These trends are driving stronger policy and regulatory focus on ESG in financial and capital markets, how investors approach investments and investee or portfolio companies, and corporations' conduct of business. Policy and regulatory efforts in many parts of the world involve the following:

- central banks in green or sustainable bond issuance, and some are developing green taxonomy and defining what qualify as green or sustainable assets for driving capital and investments towards green or sustainable developments;
- regulations on green finance, on green or ESG policies of financial institutions, including banks and investment managers, or green or ESG financial or investment products;
- regulations being enhanced or introduced on corporate ESG management and disclosures, especially on listed companies;
- evolving domestic laws on different ESG issues, such as environment laws and regulations, labour laws, modern slavery law, anti-discrimination, anti-corruption and other public interest laws, that may reflect countries' national action plans towards the SDGs.

Part 1
Hong Kong sustainable finance and accelerated focus on climate

China has been developing green finance following the Paris Agreement. There have been efforts to establish a domestic green financial system, since the *Guiding Opinions on Building a Green Financial System (No. 228 [2016])*, also the publication of the Green Bond Endorsed Projects Catalogue and the Green Investment Catalogue, being closest to China's form of taxonomy, with the welcomed proposal last year of removing clean use of fossil fuel. Besides, in 2017 the People's Bank of China was a key founder of the Network for Greening the Financial System (NGFS) among central bank regulators. In September last year, China made a surprising announcement of its intention to achieve carbon neutrality before 2060 and peak emissions before 2030.

The Paris Agreement applies to Hong Kong through China and, following China's lead, Hong Kong has similarly adopted policy focus on climate and green finance. Under Hong Kong's Climate Action 2030+ published by the Environmental Bureau in 2017, Hong Kong aims to reduce its carbon intensity by between 65% and 70% by 2030 compared with 2005 levels. Hong Kong's Green Bond Framework was adopted in March 2019, with a view to issuing green bonds to fund projects to improve the environment and facilitate the transition to a low carbon economy. In the Chief Executive's November 2020 policy address, Hong Kong has now pledged to achieve carbon neutrality by 2050.

The Hong Kong Monetary Authority (HKMA) is driving green finance both in the capacity as central bank and financial regulator respectively. The HKMA has established the Government Green Bond Programme with an inaugural US$1 billion green bond issuance in 2019 and a further offering of US$2.5 billion in January 2021, besides adopting responsible investment of the Exchange Fund.

However, more importantly, Hong Kong has a strategic role in driving capital and investments towards green or sustainable finance, being among the world's largest stock exchanges by market capitalisation, and as an international financial centre and asset management hub. With thousands of companies and securities listed on the Hong Kong stock exchange, and many of the listed companies and issuers having businesses and operations in Mainland China, broader Asia region or other parts of the world, Hong Kong's climate action and carbon footprint through these would be much more significant than the economic activities of the city itself.

This publication highlights Hong Kong's efforts in supporting market development in green or sustainable finance, covering the broad overview of policy direction as well as the current state of regulatory requirements relevant to sustainable finance or ESG in Hong Kong, including corporate ESG disclosures, green or sustainable finance investment and products, and green banking and finance.

Green and sustainable finance framework and Strategic Plan

Hong Kong's securities and futures market regulator, the Securities & Futures Commission (SFC), published its Strategic Framework for Green Finance in 2018, and the Hong Kong Monetary Authority (HKMA) on Green and Sustainable Banking. More policy and regulatory initiatives with enhanced requirements on financial institutions and corporations regarding ESG are expected, especially with respect to climate, and as part of Hong Kong's ambition to be the global sustainable finance hub of Asia.

In May 2020, the Green & Sustainable Finance Cross-Agency Steering Group (Steering Group) co-chaired by the HKMA and the SFC was established, with members comprising the Environment Bureau, the Financial Services and the Treasury Bureau, Hong Kong Exchanges and Clearing Limited (Hong Kong Exchange), the Insurance Authority and the Mandatory Provident Fund Authority. The Steering Group aims to co-ordinate the management of climate and environmental risks in the financial sector, accelerate the growth of green and sustainable finance in Hong Kong, and support the Hong Kong government's climate strategies. As part of advancing efforts towards the government's 2050 net zero goal, in December 2020, the Steering Group announced its Strategic Plan to Strengthen Hong Kong's Financial Ecosystem to Support a Greener and More Sustainable Future, setting out the key focus areas to strengthen Hong Kong's financial ecosystem to support a greener and more sustainable future, and five agreed near-term action points.

The six key focus areas are:

- strengthening climate-related financial risk management;
- promoting the flow of climate-related information at all levels to facilitate risk management, capital allocation and investor protection;
- enhancing capacity building for the financial services industry and raising public awareness;
- encouraging innovation and exploring initiatives to facilitate capital flows towards green and sustainable causes;
- capitalising on Mainland China opportunities to develop Hong Kong into a green finance centre in the Guangdong-Hong Kong-Macao Greater Bay Area; and
- strengthening regional and international collaboration.

Significantly, the need to align climate-related disclosures with Recommendations of the Task Force on Climate-related Financial Disclosures (TCFD) and to develop a unified ESG market standard or reporting framework are areas identified as requiring immediate action. The Steering Group agreed to take active steps to enhance climate-related disclosures of financial institutions and for mandatory climate-related disclosures aligned with TCFD Recommendations across relevant sectors to be expected by no later than 2025, and coverage of mandatory disclosure would be increased as soon as practicable.

One of the near-term action points in the Steering Group's Strategic Plan is to aim to adopt the Common Ground Taxonomy, which is being developed by the International Platform on Sustainable Finance (IPSF) Working Group on Taxonomies co-led by China and the EU, with a view to providing transparency to investors and companies by providing a common reference point for the definition of investments that are considered as environmentally sustainable across relevant IPSF jurisdictions and facilitating cross-border green capital flows.

Part 2
Corporate ESG disclosures and reporting

Under the Companies Ordinance (Cap 622), Hong Kong companies (unless exempted) are required to include in the business review section of their annual directors' report "a discussion on the company's environmental policies and performance and the company's compliance with the relevant laws and regulations that have a significant impact on the company" and "an account of the company's key relationships with its employees, customers and suppliers and others that have a significant impact on the company and on which the company's success depends". Another requirement of the business review is to provide "a description of the principal risks and uncertainties facing the company". Companies that meet certain specified criteria may qualify for simplified reporting and be exempted from the said requirement for business review (for example, private companies with a revenue or asset level below certain thresholds), while the requirements are generally applicable to public companies.

In addition to the said ESG disclosure requirements under the Companies Ordinance, companies listed on The Stock Exchange of Hong Kong Limited (SEHK) are further subject to disclosure requirements under the Environmental, Social and Governance Reporting Guide (Appendix 27 to the Main Board Listing Rules; Appendix 20 to the GEM Listing Rules) (ESG Reporting Guide), and the Corporate Governance Code (Appendix 14 to the Main Board Listing Rules; Appendix 15 to the GEM Listing Rules).

ESG Reporting Guide

Hong Kong is one of the first stock exchanges to require listed companies to report on ESG. The ESG Reporting Guide sets out an ESG disclosure framework, which in its latest enhancement published in December 2019 now requires mandatory disclosures in relation to board engagement and oversight on ESG matters, and requires "comply or explain" disclosure in relation to four environmental and eight social aspects. The revised ESG Reporting Guide applies to ESG Reports for financial years commencing on or after 1 July 2020, with the first batch expected to be published no later than 31 November 2021, being no later than five months after the end of the financial year (assuming 30 June 2021).

The revised ESG Reporting Guide addresses market concerns on "check-the-box" types of corporate ESG disclosures and emphasises the expectation for boards of directors of listed companies to discharge director duties in considering relevant ESG issues, materiality assessment, oversight and review.

Under the mandatory disclosure requirements, board directors are expected to provide a statement on the board's assessment of ESG issues, its ESG management approach and strategy, how the board reviews progress made against ESG-related goals and targets, and how these relate to the issuer's businesses. The ESG Report must also disclose how the company addresses materiality in ESG factors, and describe any stakeholder engagement and the significant stakeholders identified, and the process and results of the issuer's stakeholder engagement.

ESG Reporting Guide for Listed Companies:

Environmental aspects:

- emissions;
- use of resources;
- environment and natural resources; and
- climate change.

Social aspects:

- employment;
- health and safety;
- development and training;
- labour standards;
- supply chain management;
- product responsibility;
- anti-corruption; and
- community investment.

Listed companies are subject to "comply or explain" disclosures on the identified environmental and social aspects set out in the ESG Reporting Guide, as well as disclosing key performance indicators (KPIs), subject to materiality assessment. If an aspect is considered as not material, disclosure is not required other than to explain that no disclosure is made because it is not material to the business of the listed company.

In addition to the "comply or explain" matters set out in the ESG Reporting Guide, listed companies are encouraged to identify and disclose additional ESG issues and KPIs that reflect their significant environmental and social impacts, or substantially influence the assessments and decisions of stakeholders.

The ESG Reporting Guide sets out minimum parameters for reporting with a view to facilitating a company's disclosure and communication with investors and other stakeholders. The listed company may refer to existing international ESG reporting standards or guidelines for its relevant industry or sector, so long as these are comparable to the "comply or explain" provisions set out in the ESG Reporting Guide.

ESG reporting standards

The Hong Kong Exchange provides examples of international ESG reporting standards or guidelines including the CDP's Climate Change Questionnaire and Water Security Questionnaire, Climate Disclosure Standards Board's Climate Change Reporting Framework, Corporate Sustainability Assessment for inclusion in the Dow Jones Sustainability Indices, Global Reporting Initiative's Sustainability Reporting Standards, International Integrated Reporting Council's International Integrated Reporting Framework, ISO 26000 Guidance on Social Responsibility, OECD's Guidance for Multinational Enterprises and Principles of Corporate Governance, SASB Materiality Map, TCFD Recommendations, and the UN SDGs. There are also "Reference Materials on Specific Topics", and "ESG Resource Providers/ Initiatives" which include the United Nations Global Compact and the United Nations Principles for Responsible Investment.

The SFC, HKMA and the Hong Kong Exchange regularly reference and support adopting TCFD, expressing their intention to align their policies with the TCFD framework. In light of climate-related risks and adoption of the TCFD Recommendations being increasingly cited as a major priority on the global agenda, the ESG Reporting Guide incorporates certain elements of the TCFD Recommendations, while the new addition of an aspect on climate change in the ESG Reporting Guide is a clear effort to align with TCFD.

Under the Strategic Plan noted above, mandatory climate-related disclosures aligned with TCFD across relevant sectors shall be expected by no later than 2025, and coverage of mandatory disclosure would be increased as soon as practicable.

Corporate governance and proposed enhancements

The Corporate Governance Code, first introduced by the Hong Kong Exchange in 2005 and as amended, sets out the mandatory requirement for disclosure in an issuer's Corporate Governance Report and the principles of good corporate governance with two levels of recommendations: code provisions and recommended best practices. Code provisions are subject to "comply or explain" requirements, and recommended best practices are subject to voluntary disclosure and are for guidance only. Issuers are encouraged, but not required, to state whether they have complied with the recommended best practices and provide considered reasons for any deviation. The Corporate Governance Code lays out best practices guidelines and requirements relating to board composition, board meetings, board and management structure, responsibilities and accountabilities, board committees (audit committee, remuneration committee, nomination committee, risk committee (if any)), and board diversity policy.

To enhance the corporate governance standards of listed issuers in Hong Kong, board diversity has been upgraded from a code provision to a Listing Rule (Rule 13.92 to the Main Board Listing Rules and Rule 17.104 of the GEM Listing Rules) in the review of the Corporate Governance Code and the Listing Rules in 2018, requiring listed companies to adopt a policy concerning diversity of board members and to disclose this policy or a summary of this policy in the issuers' corporate governance reports.

According to the Corporate Governance Code, the board is responsible for evaluating and determining the nature and extent of the risks it is willing to take in achieving the issuer's strategic objectives, and ensuring that the issuer establishes and maintains appropriate and effective risk management and internal control systems. Such risks would include, amongst others, material risks relating to ESG. The board should oversee management in the design, implementation and monitoring of the risk management and internal control systems, and management should provide a confirmation to the board on the effectiveness of these systems.

Proposed enhancements to the Corporate Governance Code

In April 2021, the Hong Kong Exchange published a consultation paper on proposed enhancements to the Corporate Governance Code and Corporate Governance Report, as well as related amendments to the Listing Rules (CGC Review). It is proposed, among other things, to further promote gender diversity of the board of directors of listed issuers. In particular, diversity is not considered to be achieved by a single gender board and it is proposed to require all listed issuers to set numerical targets and timelines for achieving gender diversity at both (i) board level and (ii) across the workforce (including senior management), by introducing a new mandatory disclosure requirement. If the proposals are adopted, and after the revised Listing Rules become effective, there will be a three-year transition period for existing issuers with single gender boards to appoint at least a director of the absent gender. If and when the proposals under the review of the Corporate Governance Code are implemented, new listing applicants will be expected not to have single gender boards.

An upgrade to the code provisions is also proposed, by introducing the requirement to establish anti-corruption and whistleblowing policies, which are currently also required to be disclosed on a "comply-or-explain" basis under the ESG Reporting Guide, subject to materiality. To elaborate the link between corporate governance and ESG, ESG risks are proposed to be included in the context of risk management under the Corporate Governance Code.

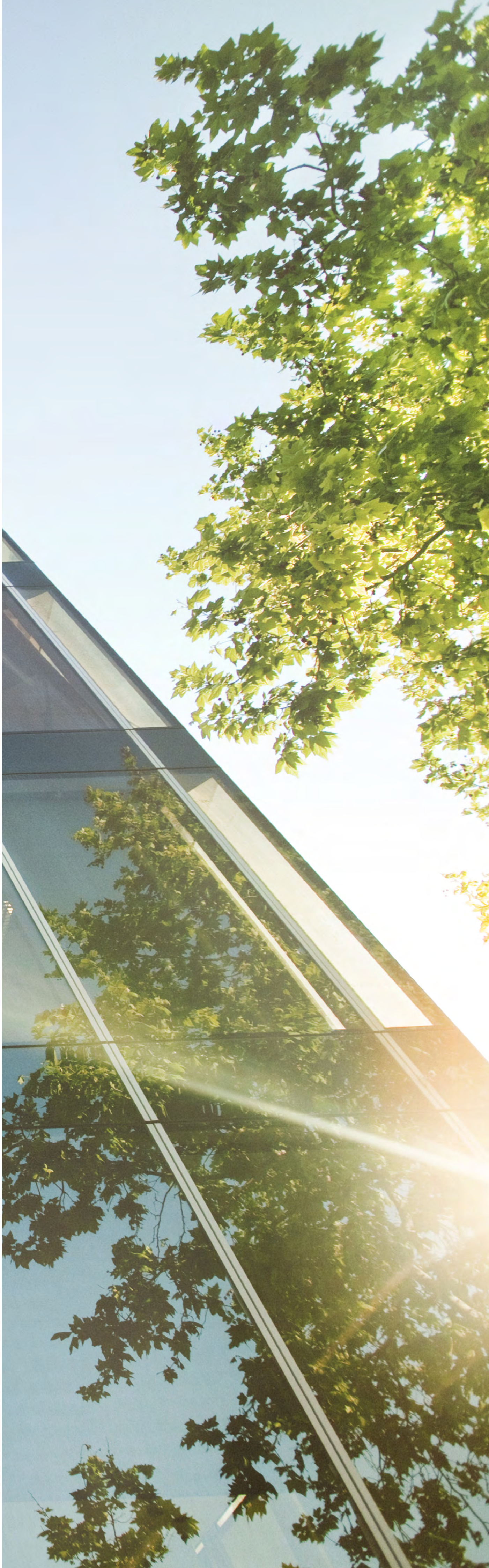
Under the CGC Review, the Hong Kong Exchange also encourages listed companies to consider adopting the TCFD Recommendations when disclosing climate-related information in compliance with the ESG Reporting Guide, and states that it will provide further guidance in this regard.

General ESG legal considerations

Other than the ESG reporting or disclosure requirements outlined above, companies in Hong Kong are subject to long-standing and existing laws in non-financial areas such as employment and labour relations, health and work safety, anti-discrimination, laws against financial crime (such as the Anti-Money Laundering and Counter-Terrorist Financing Ordinance, and the Prevention of Bribery Ordinance), and also requirements under environmental laws or regulations where relevant.

Company directors are under a duty to exercise reasonable care, skill and diligence, under the Companies Ordinance, and generally to act in the best interests of the company, as a whole, which encompasses a duty to act in the interest of the company shareholders, present and future. However, there is no specific regulatory requirement or legal form which imposes a general duty on companies or company directors on environment, society or stakeholder interests.

In the absence of specific law or legal framework such as benefit corporations in Hong Kong, with the growth of the private B Corp certifications, there are Hong Kong companies which, on an entirely voluntary basis, seek to become certified B Corps, by applying to go through the B Impact Assessment (BIA) administered by non-profit B Lab. BIA is a certification process which measures a company's ESG performance and evaluates how a company's operations and business model impact its main stakeholder groups, including its workers, community, environment and customers. Effective from January 2021, B Lab has adopted its "Legal Requirement" for Hong Kong B Corps, as a mission-lock in relation to the governance pillar in the B Corp certification process, where a B Corp commits, through its business and operations, to create a material positive impact on society and the environment, taken as a whole. Directors are to take into account, in good faith, the likely long-term consequences of decisions, the interests of employees and stakeholders, the impact on the community and environment, the company's reputation for high standards of business conduct, and the need to act fairly between members of the company.



Part 3
Green and ESG investing

Internationally, the UN-supported Principles for Responsible Investment (PRI) is a key body driving green and sustainable investing, with and for signatories who are institutional investors, asset owners and asset managers. The six Principles:

- Principle 1: incorporate ESG issues into investment analysis and decision-making processes.
- Principle 2: be active owners and incorporate ESG issues into ownership policies and practices.
- Principle 3: seek appropriate disclosure on ESG issues by the entities invested.
- Principle 4: promote acceptance and implementation of the Principles within the investment industry.
- Principle 5: work together to enhance our effectiveness in implementing the Principles.
- Principle 6: report on activities and progress towards implementing the Principles.

PRI is not a regulatory body, and becoming a signatory of the PRI is on a voluntary basis, although at the end of 2020 there were more than 3,000 signatories with aggregate assets under management of more than US$100 trillion, and accordingly PRI is a significant organisation setting international best practice standards on responsible investment and ESG. There are currently 59 PRI signatories in China and 68 signatories in Hong Kong.

With COP26 this year, there are strong accelerated efforts and net zero commitments, and PRI is encouraging signatories to work together towards net zero. UN-convened Net Zero Asset Owner Alliance, which requires signatories to commit to moving their portfolios to net-zero by 2050, was launched by UNEP FI and the PRI, and as at the end of 2020, thirty-three investors with $5.1 trillion in assets joined the initiative. Another important initiative of the investment community is the Net Zero Asset Management Initiative which brought together 30 investment managers that commit to help their asset owner clients decarbonise by 2050.

Shareholder engagement and responsible investment

The Corporate Governance Code for companies listed on SEHK requires listed issuers to disclose matters relating to meetings of shareholders and the exercise of shareholders' rights, including how shareholders can convene extraordinary general meetings and put forward proposals, and also disclosure on shareholders' communication policy (or its summary), which should include channels for shareholders to communicate their views on various matters affecting the issuer, as well as steps taken to solicit and understand the views of shareholders and stakeholders.

The SFC Principles of Responsible Ownership (PRO) adopted in 2016 involves a voluntary disclosure framework for institutional investors on shareholder engagement. Investors are encouraged to adopt the PRO by disclosing to their stakeholders that they have done so, but may either apply the PRO in their entirety and disclose how they have done so, or explain why aspects of the PRO do not, or cannot, apply to them. There are a total of seven PRO which highlight that engagement with investee companies to promote long-term success is part of investors' ownership responsibilities, and that they should:

- establish and report to their stakeholders their policies for discharging their ownership responsibilities;
- monitor and engage their investee companies;
- establish clear policies on when to escalate their engagement activities;
- have clear policies on voting;
- be willing to act collectively with other investors when appropriate;
- report to their stakeholders on how they have discharged their ownership responsibilities; and
- when investing on behalf of clients, have policies on managing conflicts of interests.

Managing and disclosing climate-related risks

In October 2020, the SFC launched a "Consultation Paper on the Management and Disclosure of Climate-related Risks by Fund Managers" (Consultation Paper), which proposed to introduce requirements for Hong Kong SFC-licensed fund managers to consider climate-related risks in their investment and risk management processes, and to make appropriate disclosures to meet investors' growing demand for climate risk information and to combat greenwashing.

Under the Consultation Paper, the SFC is proposing to amend the Fund Manager Code of Conduct and to issue a circular in order to introduce baseline requirements that shall apply to managers of collective investment schemes with respect to climate-related risks. The Consultation Paper refers to three main types of identified risks associated with climate change which could have adverse impact on the value of a wide range of financial assets and may affect asset values, namely physical risks, transition risks and liability risks, and outlines four key elements to address such risks: (a) governance, (b) investment management, (c) risk management and (d) disclosure. These four key elements are baseline requirements that are applicable to all fund managers and for certain key elements. Enhanced standards are proposed for large fund managers of assets under management (AUM) of HK$4 billion or above, including fund-level disclosure on weighted average carbon intensity (WACI) of Scope 1 and Scope 2 GHG emissions associated with the funds' underlying investments, on top of entity-level disclosures expected of all fund managers. The results of the consultation period for the proposals are yet to be announced.

As the consultation draft was issued prior to the announced net-zero commitments from China and Hong Kong, and prior to the publication of the Steering Group Strategic Plan in December 2020, the final rules may be quite different, subject to responses on the consultation and reflecting the fast-evolving landscape and climate goals in decarbonisation and transition. However, there is no doubt that fund managers in Hong Kong will be under regulatory requirements soon on disclosing and managing climate-related risks in their fund portfolios under management.

SFC-authorised green or ESG funds

For public investment funds, in accordance with its Strategic Framework for Green Finance issued in September 2018 to facilitate the development of a wide range of green-related investments, and with a view to combat greenwashing, the SFC published guidance on enhanced disclosures for SFC-authorised green or ESG funds in April 2019 in its "Circular to management companies of SFC-authorised unit trusts and mutual funds – Green or ESG funds" (Circular).

The Circular applies to all investment funds which are authorised or which seek to be authorised by the SFC, including authorised European or UK UCITS funds, Mainland funds authorised under the Mainland-Hong Kong mutual recognition of funds arrangement, as well as Hong Kong domiciled public investment funds. Pursuant to the Circular, SFC-authorised unit trusts and mutual funds that claim to be green or ESG funds must disclose how green or ESG factors are incorporated into their investment strategy and investment selection process.

An SFC-authorised green or ESG fund may incorporate one or more of the globally-recognised green or ESG criteria or principles set out in Annex 1 to the Circular as their key investment focus and reflect such in their name and investment objective or strategy. The current list in Annex 1 is:

- United Nations Global Compact Principles;
- United Nations Sustainable Development Goals;
- Common Principles for Climate Mitigation Finance Tracking;
- Green Bond Principles of the International Capital Market Association; and
- Climate Bonds Taxonomy of the Climate Bonds Initiative.

However, this list is not exhaustive, and "other green or ESG criteria or principles recognised globally or nationally, or reference benchmarks or indices which in their construction and management adopted any of the green or ESG criteria or principles above may be considered by the SFC on a case-by-case basis".

The Circular requires such green or ESG funds to disclose, at a minimum, the following information in their offering documents:

- a description of the key investment focus and how it is considered green or ESG-related;
- a description of the investment strategies adopted, which includes but is not limited to disclosure of the investment selection process and criteria;
- a description of whether an exclusion policy has been adopted by the fund and types of exclusion;
- a description of risks associated with the green and ESG fund's investment theme; and
- any other information considered necessary by the manager for investors to make an informed judgment of the investment.

The manager of the green or ESG fund should regularly monitor and evaluate the underlying investments, with proper procedures in place to make sure it continues to meet the stated investment objective and requirements set out in the Circular, and is required to provide to the SFC either a self-confirmation of compliance or a confirmation on compliance supported with independent third party certification or fund label.

A list of authorised green or ESG funds which fulfil the requirements set out in the Circular is now available on the SFC's website.

The Hong Kong Exchange – STAGE

The Hong Kong Exchange has established an online portal, the Sustainable & Green Exchange (STAGE), providing information, access and transparency on the sustainable finance ecosystem, including a product repository of exchange-traded sustainable or green funds, as well as green bonds, sustainable bonds or social bonds listed on SEHK.

Mandatory provident funds

In October 2019, the International Organisation of Pension Supervisors (IOPS) issued supervisory guidelines to encourage supervisory authorities to require pension funds to integrate ESG factors into their investment and risk management process. As a member of IOPS, Hong Kong MPFA has stated in its 2019-2020 Annual Report that it will consider how to adopt such guidelines.

In a circular issued in November 2018 and further reiterated in its 2019-2020 annual report, the MPFA stated that it is "good practice for pension funds to disclose their approach to ESG factors in their investment policies" and it "highly encourages" trustees and investment managers of mandatory provident funds (the mandatory retirement scheme in Hong Kong) to consider taking into account the relevant international ESG standards into their decision-making process and disclosing their approach to ESG factors to scheme members. It also further encourages MPF trustees to discuss with their investment managers the possible inclusion of green bonds in their MPF portfolio holdings.

Part 4
Green and sustainable banking and finance

As bank regulator, the HKMA has adopted a three-phased approach in developing green and sustainable banking in Hong Kong:

- Phase I – developing a common framework to assess the "Greenness Baseline" of individual banks (Common Assessment Framework);
- Phase II – engaging the industry and other relevant stakeholders in a consultation on the supervisory expectation or requirement on green and sustainable banking, with a view to setting tangible deliverables for promoting the green and sustainable developments of the Hong Kong banking industry;
- Phase III – after setting the targets, implementing, monitoring and evaluating banks' progress in this regard.

For Phase I, in July 2019 the HKMA formed a Working Group on Green and Sustainable Banking consisting of 22 representatives from the banking industry to develop the Common Assessment Framework for assessing the "greenness baseline" of individual banks or institutions. The HKMA finalised the framework and launched the first round of assessment in May 2020.

The Common Assessment Framework collects information surrounding 20 elements grouped under six broad categories covering stages of development in preparations for managing climate and environmental risks. The six broad categories are governance, corporate planning and tools, risk management process, business policies, products and services, performance and resources, and disclosure and communication.

Banks or financial institutions regulated by the HKMA are required to conduct this self-assessment exercise focusing on the financial risks (e.g. credit risk and market risk) associated with climate and environmental issues, and to report their level of development or progress in relation to different elements under each broad category. This is intended to facilitate banks or financial institutions in formulating their strategies and approaches to address climate and environmental risks, and also to inform its design of the supervisory expectations and approach under the second phase of its three-phased approach.

Phase II of the three-phased approach by the HKMA to support and promote Hong Kong's green finance development is to engage the banking industry and other relevant stakeholders in consultation on supervisory expectation or requirement on green and sustainable banking. A white paper was published in June 2020 outlining the HKMA's thinking on its supervisory approach to addressing climate-related issues and, to a lesser extent, broader sustainability issues, as summarised in nine guiding principles in the areas of governance, strategy, risk management and disclosure.

The HKMA aims to adopt a proportionate approach for its supervisory requirements appropriate to size and scale. The development of the supervisory requirements will take into account the "greenness assessment" results from the Common Assessment Framework, the feedback on its engagement with the industry and international developments.

Green or sustainability-linked bonds

Green bonds and sustainability-linked bonds are increasing in issuances globally. In May 2019, the Hong Kong government issued the largest sovereign green bond at the time at US$1 billion, which was four times oversubscribed and triggered a rapid growth in green bond issuance in Hong Kong. The second batch of government green bonds totalling US$2.5 billion was offered in January 2021, among which the 30-year tranche is the longest-tenor bond issued by the government and the longest-tenor US$-denominated government bond in Asia to date.

To encourage green and sustainable bond issuance and lending in Hong Kong, Hong Kong's 2021-22 Budget announced the Green and Sustainable Finance Grant Scheme (Grant Scheme), with details published in

May 2021, to provide eligible green and sustainable bond issuers and loan borrowers with subsidy to cover expenses of bond issuance and external review services. The Grant Scheme is available for the next three years for first-time issuers of green and sustainable bonds (with no such issue in the five years prior to the bond's pricing date), for issuance size of at least HK$1.5 billion (or equivalent in foreign currency), and being, at issuance, issued in Hong Kong to 10 or more persons or, if issued to fewer than 10 persons, none of whom is an associate of the issuer. "Issued in Hong Kong" means half or more of the lead arranger(s) are HKMA-recognised arrangers, or where at least half of the loan amount is borrowed from Hong Kong-based lenders.

The grant amount for each green and sustainable bond issue is half of the eligible expenses, up to HK$2.5 million where the bond, its issuer or its guarantor(s) possesses a credit rating by a rating agency recognised by the HKMA, or HK$1.25 million otherwise. Each issuer can apply for a maximum of two green and sustainable bond issuances.

The Grant Scheme also offers subsidy of full eligible external review costs of up to HK$800,000 per bond issuance or loan, for green and sustainable bond issuers or borrowers, without limiting to first-time issuers or borrowers, for pre-issuance external review services by an HKMA-recognised external reviewer. Eligible bond issuance size is at least HK$200 million (or equivalent in foreign currency), and being, at issuance, issued in Hong Kong to 10 or more persons or, if issued to fewer than 10 persons, none of whom is an associate of the issuer. Eligible green or sustainable loans must have a loan size of at least HK$200 million (or equivalent in foreign currency. Eligible expenses include pre-issuance external review and post-issuance external review and reporting.

Arrangers and external reviews may separately apply to HKMA for recognition before being appointed to arrange or provide external review services on green or sustainable bonds or loans, or such application(s) may be submitted at the same time with the grant application for a bond or loan. With respect to external reviewers, the HKMA will consider whether an external review has sizeable presence in Hong Kong, satisfactory observance of internally recognised standards, and proven track record in providing external review services to green and sustainable bonds and loans, especially international issuances.

The HKMA may consider application by external reviewers who reference internally recognised standards such as the Climate Bonds Standard of the Climate Bonds Initiative, the ICMA Green Bond Principles, the ICMA Social Bond Principles, the ICMA Sustainability-linked Principles, or the Green Loan Principles or Sustainability-linked Loan Principles of Asia Pacific Loan Market Association, Loan Market Association and Loan Syndications & Trading Association, or other standards that may be accepted by HKMA.

Growth of green or sustainable banking, green or sustainability-linked bonds or loans would be particularly significant in providing capital and financing to corporations and projects which align with green or climate targets or sustainable principles. Hong Kong's overall coordinated policy efforts to develop green and sustainable finance, together with the Grant Scheme, are highly strategic for driving investments towards climate mitigation or adaptation, and which may steer towards meeting evolving climate goals, crucial for driving capital and investments towards the transition pathways for achieving net zero climate targets. As social bonds or sustainability-linked bonds or loans are also eligible under the Grant Scheme, this may encourage "just transition" whereby social issues are taken into account alongside climate and other environmental considerations in the re-design and future of a de-carbonised sustainable economy.

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